Massachusetts Electric
A National Grid Company

October 30, 2003

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: <u>Standard Offer Service and Now Is the Time to Choose Program</u>

Dear Secretary Cottrell:

Massachusetts Electric Company and Nantucket Electric Company (together "Mass. Electric"), working with Constellation New Energy, Dominion Retail, MXEnergy Electric, Inc., Select Energy, Inc. and Strategic Energy (together, "Participating Suppliers") propose to implement a joint information campaign with our customers, called *Now Is the Time to Choose*. As described more fully below, under the program, Participating Suppliers may offer to Mass. Electric's Standard Offer Service customers a lower price for electricity for the period through the end of the Standard Offer Service period of February 28, 2005. To facilitate the successful implementation of the *Now Is the Time to Choose* program, Mass. Electric is seeking the Department's approval to maintain the Standard Offer Service Fuel Adjustment ("SOSFA") at today's level of 1.424¢ per kilowatt-hour for the period January 1, 2004 through the remainder of the Standard Offer Service period. In addition, Mass. Electric is requesting the Department's approval of the *Now is the Time to Choose* program and a finding that it is consistent with Mass. Electric's restructuring settlement and wholesale Standard Offer contracts approved by the Department in Docket No. D.P.U./D.T.E. 96-25.

The Current Market for Electricity and Standard Offer Prices

When Mass. Electric restructured its operations, opened its retail markets to competitive suppliers, and divested its affiliate-owned generation resources, it entered into contracts for Standard Offer Service that provided retail electric supplies for customers who were served by Mass. Electric on the date that markets were opened, or March 1, 1998, and who had not yet chosen an alternative supplier in the market place. See Mass. Electric Restructuring Agreement, Sections I.B.1(d), I.B.5, and I.B.9. Standard Offer Service was designed as a transitional service; customers were expected to move to the market when the price of Standard Offer Service escalated above the prices in the competitive market. The prices for Standard Offer Service began at 2.8¢ per kilowatt-hour and increased at preset amounts over the Standard Offer Service

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period to 5.1¢ per kilowatt-hour in 2004. Section I.B.1(d). In addition, the prices are subject to the Standard Offer Service Fuel Adjustment surcharge, which today is 1.424¢ per kilowatt-hour.

Under the original restructuring settlement, the Standard Offer Service prices were designed to escalate steadily during the Standard Offer Service period (which ends in March 2005) and at some point cross over to become higher than the market price of electricity. At that point customers would realize the savings in the market by transferring to competitive contracts. As the Department found in Docket D.P.U./D.T.E. 96-25-A, p. 34 (July 14, 1997): "The standard offer provisions included in the Revised Amended Settlement also provide for a reasonable transition to a competitive market that affords important consumer protections." Among those features, were the following (Id, at pp. 34-36, emphasis supplied, footnote omitted):

> First, the design of standard offer service will ensure that even non-participants in the competitive market see benefits from restructuring, i.e., reduced rates. This is consistent with the Department's principles of providing near term rate relief and assuring benefits for all classes of customers. Second, this design avoids the need for all customers to exercise choice immediately. This approach will prevent, in large measure, the kinds of confusion and anxiety that have attended previous efforts at promoting competition, a concern that was frequently cited by consumers during the Department's public hearings in D.P.U. 96-100. Third, the price-cap approach to the design of standard offer service provides an appropriate inducement for the Company to obtain generation supplies to serve standard offer customers at the lowest possible price. This design will, therefore, foster the further development of competition in the bulk power market. Fourth, the design of standard offer service will lead to a progressive increase in competition as the standard offer price ceiling rises, and any short-term impairment to competition will be cured over time. Fifth, the concerns of some commenters that the design of standard offer service will afford an unfair marketing advantage to the Company's marketing affiliate are not well-founded. The Department's Standards of Conduct, 220 C.M.R. 12.039(11), will prohibit the Company from promoting or marketing the services of its affiliated supplier. For all of these reasons, the Department finds that MECO's proposal for standard offer service is consistent with the Department's restructuring goals principles and, on balance, reasonable.

The Department's original objectives are now being realized. Until now, the Standard Offer Service price has been consistently below the market price for electricity as evidenced by Mass. Electric's shorter term procurements of Default Service for residential customers in the wholesale market. See Attachment 1. Although this circumstance has demonstrated that Standard Offer Service has been a favorable arrangement for customers (particularly when coupled with the sale price for the generating resources that were divested at the same time), the relatively low prices for Standard Offer Service have impeded the development of the competitive market for electricity. As a result, only a small percentage of customers have migrated to competitive service. During the billing month of September 2003, only about 1.8 percent of Mass. Electric's customers have moved to the competitive market.[1]

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[1] The percentages by rate class are as follows: Residential—0.75%; Small C&I—7.78%; Medium C&I—15.99%; Large C&I—34.09%; Streetlights—23.06%; Total—1.77%.

The price shift contemplated in the original design of the Standard Offer Service pricing pattern is now occurring. The Standard Offer Service rate including the SOSFA is 6.124¢ per kilowatt-hour, and is expected to increase to 6.524¢ per kilowatt-hour on January 1, 2004 when the base Standard Offer Service price increases from 4.7¢ per kilowatt-hour to 5.1¢ per kilowatt-hour. For the first time, the total Standard Offer Service rate is above the 5.7¢ per kilowatt-hour rate for the fixed-price option for residential Default Service that will become effective on November 1, 2003, and even further above the average Default Service bid of 5.3¢ per kilowatt-hour accepted for 50 percent of the residential load commencing in May 2004. As a result, the conditions contemplated in the Standard Offer Service pricing design are being realized and it is time for an education program for customers informing them that the competitive market may provide a better alternative electricity supply than continuing on Standard Offer Service. These conditions form the basis for the *Now Is the Time to Choose* program.

Now Is the Time to Choose

Under the *Now Is the Time to Choose* program, Participating Suppliers have agreed to join Mass. Electric's *New Choices* program, and, if future market conditions allow, to provide offers consistent with their respective business practices to customers that are below the Standard Offer Service rate for the remainder of the Standard Offer Service period or at least through February 2005. Mass. Electric would in turn agree to provide informational support to Participating Suppliers, through letters and seminars to medium and large commercial and industrial ("C&I") customers, and through bill messages or inserts to residential and small C&I customers. At this point, Mass. Electric has received expressions of interest from the following suppliers: Dominion Retail and MXEnergy (on the condition that it receives a license, which is now pending before the Department) for residential and small C&I customers, and Constellation NewEnergy, Select Energy, Strategic Energy, and Dominion Retail for medium and large C&I customers. The details of the informational programs for these customers will be developed by Participating Suppliers and Mass. Electric over the next several weeks. In addition, Mass. Electric will hold extra training sessions to the extent necessary to register suppliers who are new entrants to the Massachusetts competitive supply market.

Setting a Standard Offer Service Floor Price and Reconciling Over and Under Recoveries

The key to the successful implementation of the *Now Is the Time to Choose* program is the determination of a firm Standard Offer Service rate for the period beginning January 1, 2004 and running through the remainder of the Standard Offer Service period, ending on February 28, 2005. By establishing a firm rate for the remainder of the Standard Offer Service period, Participating Suppliers know the rate that they must beat to successfully participate in the program, and Mass. Electric can assure its customers that if they receive an offer at or below the stated Standard Offer Service rate, they will be better off by moving to the market. Mass. Electric is proposing to set a firm price for Standard Offer Service equal to the 2004 base Standard Offer Service rate of 5.1¢ per kilowatt-hour plus the currently effective SOSFA surcharge of 1.424¢ per kilowatt-hour. As a result, under Mass. Electric's proposal, the total Standard Offer Service rate during the period from January 2004 through February 2005 would not be less than 6.524¢ per kilowatt-hour. Under the proposal, the SOSFA surcharge would be allowed to increase if oil and natural gas prices increased and the current SOSFA surcharge was inadequate to recover the resulting fuel index payments incurred under the wholesale Standard Offer Service supply contracts, or to reflect any additional back out credits adopted by the Department for Standard Offer Service.

Mass. Electric has evaluated the reasonableness of this value for the SOSFA surcharge under a range of scenarios. The reasonableness of the firm price depends on two primary factors—(1) the future fuel index payments during the period ending February 28, 2005, and (2) the migration rate of customers away from Standard Offer Service during the same period. As shown on Attachment 2, Mass. Electric's projected payments to Standard Offer Service suppliers depend very much on the level of the fuel index that will occur during the period through February 28, 2005. The first column in Attachment 2 shows the estimated Standard Offer Service deferral balance, consisting primarily of fuel index payments, that would be incurred if the oil and natural gas futures prices in the last week of August 2003 were to be realized through December 2004 (two months before the end of the Standard Offer Period, when the wholesale Standard Offer Service contracts for most of Mass. Electric's load expire), and resulting estimated under recovery of approximately $25.4 million that would remain at the that time. The second column shows the same information if the fuel prices in the last week of September were used in the analysis, which would produce an estimated over recovery of approximately $55.8 million through December 2004. Finally, if October 10, 13 and 14 were used, Mass. Electric estimates an under recovery of approximately $2.5 million through December 2004.

All of these analyses assume that no migration occurs away from Standard Offer Service. Because Mass. Electric already has accrued an estimated under recovery at September 2003 of approximately $64 million, and is expected to carry an under recovery of this amount through at least the first half of 2004, migration away from Standard Offer Service increases the level of under recovery at the end of the period. For example, if 10 percent of the load migrated away from Standard Offer Service on January 1, 2004, the estimated under recovery at the end of 2004 would increase by about $10 million, assuming recent fuel price forecasts are realized. Under a more optimistic view of fuel prices (for example, using the September values noted above), a 10 percent migration on January 1, 2004 would result in about a $15 million reduction in the estimated over recovery. Thus, a thirty-five percent migration rate over the period would eliminate the estimated over recovery that is projected even under the most optimistic September values of natural gas and fuel oil. Migration at this level can also be achieved if 75 percent of the Rate G-2 and G-3 (medium and large C&I) Standard Offer Service load converts to competitive suppliers. Conversion rates for customer classes will depend directly on the market prices of electricity during the period and the success of the *Now Is the Time to Choose* program. The point is that the more successful Participating Suppliers are in convincing customers to save money, the greater the residual under recovery left at the end of the period.

Based on the analysis set forth in Attachment 2, Mass. Electric requests the Department to allow it to maintain its currently approved SOSFA surcharge in place for the remainder of the Standard Offer Service period to set a firm price for Standard Offer Service. Although Mass. Electric has traditionally updated its SOSFA analysis from time to time, the fixing of the SOSFA factor when reasonably necessary to collect an ongoing under-recovery is consistent with the Department's approval of Fitchburg Gas and Electric Company's SOSFA surcharge in 2003[2].

[2] Fitchburg Gas & Electric Company, D.T.E. 02-84, January 6, 2003.

As the analysis in Attachment 2 shows, particularly when the risk of migration is considered, the currently effective SOSFA is likely to remain reasonable and necessary through the remainder of the Standard Offer Service period, and, thus, our proposal is consistent with the Fitchburg approval.

In the event that the SOSFA is too high and Mass. Electric over-collects during the Standard Offer Service period, Mass. Electric will reconcile the over recovery as part of its normal reconciliation process and return the balance with interest using the customer deposit rate as set forth in Section I.B.5(a) of its restructuring settlement. Under that section, the over recovery is "credited to all of Mass. Electric's retail delivery customers through a uniform cents per kilowatt-hour factor in the following year" and thus does not affect the Standard Offer Service rate that Mass. Electric is proposing to establish to facilitate the development of the retail market.[3] In the event that the reconciliation produces an under recovery at the end of the Standard Offer Service period, Mass. Electric would use the procedure set forth in Section I.B.5(b) of the restructuring settlement, and defer and collect the under recovery in 2010. Thus, Mass. Electric will complete the reconciliation at the end of the Standard Offer Service period and collect or return any funds to all of its customers using the procedures set forth in Section I.B.5(a) and (b). Mass. Electric will also continue to monitor the over or under recoveries in the Standard Offer Service reconciliation, which will include fuel index payments and SOSFA revenue.

Advantages of the *Now Is the Time to Choose* Program

The *Now Is the Time to Choose* program presents several significant advantages to our customers. First, Mass. Electric's customers will have new lower-cost alternatives to Standard Offer Service. These new options will produce direct savings to customers who choose to use the information provided by the program and purchase electricity from a Participating Supplier. Because the Participating Supplier's offer must extend at least to March 2005, customers are assured that at least one offer will provide savings over Standard Offer Service.

Second, the program should add competitive suppliers to Mass. Electric's *New Choices* program and provide more alternatives for all customers. Although Participating Suppliers must extend an offer through the Standard Offer Service period, nothing prevents Participating Suppliers from offering, or customers from selecting, shorter term power purchase arrangements. The decline in the average bid price of Mass. Electric's partial Default Service procurement for the second six months of its most recent twelve month procurement indicates that customers may prefer a shorter contract now to maintain an opportunity to sign lower cost contracts in the future. These choices should be available in the market and under the *Now Is the Time to Choose* program.

Third, the migration from Standard Offer Service to the market prior to the end of Standard Offer Service reduces the level of Default Service load that would need to be procured

[3] If lower fuel prices give rise to an over recovery during the period, Mass. Electric may implement a credit to the retail delivery services component of its rates prior to the end of the Standard Offer Service period to assure that no significant over recovery of funds accrues. In any event, Mass. Electric will monitor over and under collections and report them to the Department periodically.

at the end of the Standard Offer Service period. The avoidance of the "cliff effect" as Standard Offer Service for all the State's utilities comes to an end will make the wholesale market more liquid and stable.

Fourth, the movement to longer term contracts at the retail level, which will in turn be backed by longer term contracts at the wholesale level, will help the development of both markets. Under the program, Participating Suppliers will be given the opportunity to make offers to hundreds of thousands of retail customers. The offers will extend at least fourteen months. This new market activity will improve forward price disclosure in the competitive market, facilitate longer term power supply and Renewable Portfolio contracts, and stabilize revenues for both Participating Suppliers and wholesale generators.

Consistency with Restructuring Settlement and Orders In Docket Nos. D.P.U./D.T.E. 96-25 and 97-94 (the Divestiture Docket)

Following discussions of the *Now Is the Time to Choose* program with retailers, TransCanada wrote the letter included in Attachment 3. Other wholesale Standard Offer Service suppliers may express similar concerns. Accordingly, it is appropriate in this filing to request a finding from the Department that the implementation of the *Now Is the Time to Choose* program is consistent with Mass Electric's restructuring settlement and the basis for the Department's approval of the wholesale Standard Offer Service agreements at the time of that settlement.

The Department should find that the implementation of the *Now Is the Time to Choose* program is consistent with its competitive policies articulated as part of industry restructuring, Mass. Electric's own restructuring agreement, and the wholesale Standard Offer Service contracts that were executed to implement those policies and that agreement. In the Order approving the restructuring settlement quoted above, the Department recognized that the purpose of Standard Offer Service from the outset was a "reasonable transition mechanism" that avoided the need for customers to choose a new supplier at the outset of customer choice, but that contained price increases, which would over-take the market. All parties expected that when the retail prices for Standard Offer Service did over-take market prices, Mass. Electric would inform its customers so that the customers could move to the market and the original goals of industry restructuring would be achieved. The risks of customer migration from Standard Offer Service were left with New England Power Company ("NEP"), which was the wholesale Standard Offer Service supplier initially, and the risks of migration were known by the Standard Offer Service suppliers when they assumed their obligations for supply from NEP under the wholesale Standard Offer contracts.

For example, under the Wholesale Standard Offer Contract with USGenNE, later assumed in part by TransCanada, Standard Offer Service was defined as "the electric service provided by MECO pursuant to the Massachusetts Restructuring Agreement: (i) to retail customers in MECO's Service Territory during the period, if any, during the term of this Agreement preceding the Retail Access Date; and (ii) to all of MECO's retail customers on the Retail Access Date that do not elect to obtain their electric supply from an alternative supplier on or after the Retail Access Date through December 31, 2004." As TransCanada recognized in its petition to FERC when seeking to acquire the Ocean State project from USGenNE and a portion of the wholesale Standard Offer Service contract, Docket EC-98-000, Application, pp.10-12, it stepped into NEP's shoes as the wholesale Standard Offer Service provider. In short, the expected movement of Standard Offer Service customers to the market was known by wholesale Standard Offer Service suppliers when they executed the Standard Offer Service supply contracts at the time of the divestiture.

Nothing in Mass. Electric's contracts with wholesale suppliers of Standard Offer Service preclude or prevent Mass. Electric from informing its customers that better opportunities for electric supply are now available in the market place. The Department should find that Mass. Electric simply is not required to remain silent when its customers can benefit by choosing an alternative supplier of electricity. In fact, the design of the pricing in Standard Offer Service was based on the expectation that the Standard Offer Service rate would at some point exceed the market price. Mass. Electric always contemplated that when that event occurred, the Company would inform its customers that *Now Is the Time to Choose.* Any attempt made by a supplier to draft the contracts in a way that precluded Mass. Electric from exercising its rights to communicate with its customers would have been resisted, and no supplier even attempted to restrict Mass. Electric's rights in this regard.

The circumstance contemplated in the Standard Offer Service pricing design has now occurred. We have proposed the informational program that is central to achieving the Department's initial restructuring goals. We ask the Department as part of its action on our request to state expressly that the implementation of the *Now Is the Time to Choose* program is consistent with Mass. Electric's obligations under the restructuring agreement and is authorized under its wholesale Standard Offer Service agreements that were approved by the Department as part of that restructuring settlement.

Conclusion

Accordingly, we request the Department to: (1) authorize Mass. Electric to maintain the currently approved SOSFA surcharge of 1.424¢ per kilowatt-hour in place through the remainder of the Standard Offer Service period; (2) approve the *Now Is the Time to Choose* program; and (3) find that the *Now Is the Time to Choose* program is consistent with the terms and intent of the wholesale Standard Offer Service contracts that Mass. Electric has executed and the Department has approved following the divestiture and restructuring.

Thank you for your attention to our filing.

Very truly yours,

Thomas G. Robinson
Amy G. Rabinowitz
Attorneys for Massachusetts Electric Company
And Nantucket Electric Company

c. Joseph Rogers, Department of the Attorney General
Angela O'Connor, Associated Industries of Massachusetts
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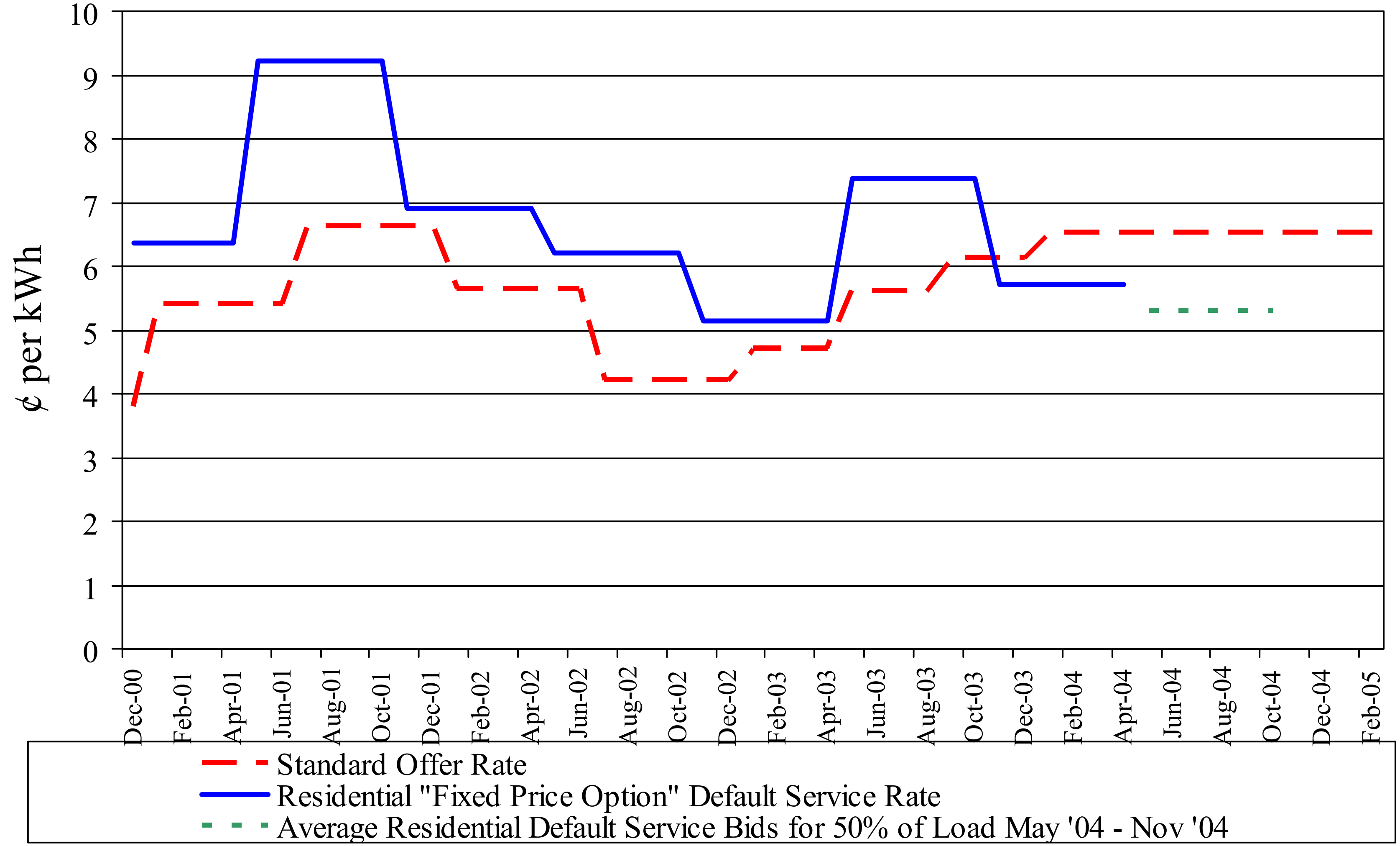
Jeff Perry, Mirant Americas Retail Energy Marketing, LP
Megan Saunders, Sempra Energy Solutions
Malcolm Ticknor, Tractebel

Attachment 1

Comparison of Standard Offer Service Rate
And
Residential Fixed Price Default Service Rate

Comparison Of Residential Default Service Rate And Standard Offer Rate



National Grid

Attachment 2

Summary of Standard Offer Service Deferral Estimates

Massachusetts Electric Company
Nantucket Electric Company

Standard Offer Deferral Estimates at Different Fuel Price Points

		Carry 2003 SOSFA into 2004		
Oil and Gas Futures Values as of:		August 26, 27, and 28, 2003	September 25, 26, and 29, 2003	October 10, 13, and 14, 2003
Rate Path:	Period	9/1/03-12/31/03: 1.424¢/6.124¢	9/1/03-12/31/03: 1.424¢/6.124¢	9/1/03-12/31/03: 1.424¢/6.124¢
	Period	1/1/04-12/31/04: 1.424¢/6.524¢	1/1/04-12/31/04: 1.424¢/6.524¢	1/1/04-12/31/04: 1.424¢/6.524¢
Estimated Deferral Balance @ (in millions $):				
September 30, 2003		($63.7)	($63.7)	($63.7)
December 31, 2003		($67.5)	($61.3)	($63.4)
March 31, 2004		($71.9)	($50.9)	($63.1)
June 30, 2004		($61.1)	($22.6)	($48.2)
September 30, 2004		($50.2)	$11.3	($31.4)
December 31, 2004		($25.4)	$55.8	($2.5)

Attachment 3

TransCanada Power Marketing Letter

TransCanada
In business to deliver ™

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October 14, 2003 **Via Federal Express**

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Associate General Counsel
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Mr. Michael J. Hager
Vice President
National Grid USA Service Company
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Re: Amended and Restated MECo Wholesale Standard Offer Service Agreement II, dated September 1, 1998 ("Standard Offer Agreement")

Gentlemen:

Thank you for your presentation on "After the Standard Offer" last Friday, October 10, 2003. As I understand it, and as documented in your handouts, Massachusetts Electric Company is contemplating undertaking a "joint marketing program" to encourage its customers to leave Standard Offer service.

As you know, Massachusetts Electric Company has contracted with TransCanada Power Marketing Ltd. for a portion of its Standard Offer power supply. TransCanada has fully honored its obligations to Massachusetts Electric since the beginning of that contract's term in 1998.

In your presentation last Friday, you stated that Massachusetts Electric was contemplating undertaking its program because the Company's default service was currently priced below Standard Offer service, indicating that perhaps for the first time since the inception of Standard Offer, power market prices have fallen below Standard Offer prices.

Massachusetts Electric has a good faith obligation to allow TransCanada the opportunity to benefit from the Standard Offer Agreement, much as Massachusetts Electric and its customers have benefited from the Agreement since 1998. Any "joint marketing program" or other initiative wherein Massachusetts Electric actively promotes its customers to leave Standard Offer undermines its obligations under the Standard Offer Agreement. Please be informed that TransCanada reserves all legal rights to seek damages from Massachusetts Electric Company in such event.

Very truly yours,

William C. (Bill) Taylor
Vice-President, Eastern Power